AIPLA

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Patented Transactions Hearing
Internal Revenue Service
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My name is Brad Forrest. I am a licensed patent attorney, registration number 30,837, currently practicing with the law firm of Schwegman Lundberg and Woessner in Minneapolis, Minnesota. I'm here today testifying on behalf of the American Intellectual Property Law Association, AIPLA.

AIPLA is a national bar association with more than 17,000 members, most of whom are lawyers and patent attorneys in private, corporate, government and academic positions. AIPLA supports the proposed rules, and would like to provide some background on the patent process and some constructive feedback on the proposed rules with the desire that certain aspects of the rules will be clarified prior to finalization. AIPLA believes that with some simple modifications to the proposed regulations, much clarity in reporting obligations can be provided.

I would like to start by providing some background on patents, and the process of drafting, prosecuting and enforcing patents. With this background, it will be clear that some minor modifications to the proposed rules will provide a much needed clarity, and result in more relevant reporting of patented transactions, saving the IRS, patent owners and patent licensees valuable time and resources.

A patent is a description of an invention with sufficient detail to enable one of ordinary skill in the art to make and use the invention without too much experimentation. The patent typically includes drawings, block diagrams or flowcharts that further illustrate the invention. Multiple inventions may be described in a single patent. A patent may include text that merely provides background information or that speculates as to potential benefits of an invention.

Each patent ends in one or more "claims." The claims are key to what a patent actually covers. A claim is a single sentence that provides a word-based description of an invention. Each claim should describe an invention clearly, and must contain limitations adequate to distinguish the invention from the prior art. In other words, the claims provide notice as to what the patent covers.

To infringe a patent, an infringer must do all that is recited in at least one of the claims of an issued patent. The patent may describe many things that are not claimed. Claims may also be added, modified or cancelled while the patent is being examined by the Patent and Trademark Office, which may take many years. Further, under the provisions of 35 U.S.C. § 122(a), patent applications are held in confidence by the patent office until they are published, usually 18 months after application. If not published or allowed, the application may be held in confidence forever.

While it may be hard to believe, patent attorneys are more literal beings than accountants. Given the current wording of the proposed regulations, and example 5 in particular, patent attorneys would likely encourage protective filings based on the descriptions in applications, as opposed to what is actually claimed and covered by the patent.

For example, a patent that describes a business operation management system, such as ways to track inventory and better match inventory to product sales by using an improved RF tag, may be literally interpreted under the proposed regulations as a patent whose subject is a "tax planning method," simply because such better matching may affect federal income tax, and hence fall within the definition of a "tax planning method."

The claims of the patent may be limited only to a better RF tag allowing tracking of inventory. The claims may have nothing to do with any tax planning method or tax avoidance scheme. We would not believe that the IRS is interested in such a patent. Yet the patent appears to literally meet the criteria for the reporting requirement under the proposed regulations because the detailed description may make passing reference to a tax advantage, even though the tax planning method is not claimed. It would also be extremely difficult and financially burdensome for an owner of hundreds if not thousands of patents to determine whether or not a patent application has a description in it that might be related to a tax planning method.

Patents are licensed for many different reasons. Many companies in the computer industry are cross licensed to large groups of patents. Such licenses typically define a field of use, such as database applications, disk drive devices, or computers. All the patents owned by the company may be included in a license. If one of the patents being licensed happens to have in its description section a reference that in some way relates to a tax planning method, even though the patent does not claim a tax planning method, this type of license may be considered a reportable transaction under the proposed regulations.

Some patent owners work aggressively to license their patents through vigorous legal enforcement. A targeted company may purchase a license just to avoid a lawsuit if the price is right. Just as the IRS recognizes that the grant of a patent does not represent a government endorsement that a described tax planning method is acceptable, the purchase of a license should not be taken as proof that any claimed tax planning method is actually being used by the licensee. It should also be clear that reporting a patented transaction should not be admissible as evidence in claim interpretation and not create any estoppel in any subsequent legal action involving any patent subject to the reporting requirement.

A few minor changes in the wording of the proposed regulations would alleviate the above concerns, and reduce the number of irrelevant protective filings of patented transactions. AIPLA suggests the following changes be made:

First, revise the definition of "tax planning method." Currently, it covers things designed to affect taxes. We propose to change the words "designed to affect", to "primarily affecting". Further, expand the exclusions to exclude patents having claims directed primarily toward business operation methods. These changes will make it clear that the previous example of a method of tracking inventory should not be included as a reportable transaction.

Second, revise the definition of "Patent" to exclude "patent applications". As described above, a patent application may have claims in it that are modified, cancelled or added during the prosecution of the application. The application may never issue as a patent. In fact, patent applications in the business method examining unit of the patent office have historically had an issuance rate below 22%. Given the changing nature of the application claims, and the low issuance rate, reporting transactions related to patent applications should not be required. Excluding patent applications from the reporting requirement would further remove a conflict that exists between the reporting requirements and the obligation of the patent office to keep applications secret until published or issued. It does not make sense for one administrative agency to be statutorily bound to hold something in secret, only to have another administrative agency force disclosure of the patent application.

Finally, revise the definition of "patented transaction." The definition of a patented transaction should be modified to refer to the claims of the patent. In particular, the language that occurs twice in 7 (ii) (B): "is the subject of the patent" should be modified to read "is covered by one or more claims of the patent". This will remove the need to track all descriptions in all patents to comply with the broad literal scope of the current proposed regulations. This clarifies that only claimed tax planning methods bring a patent within the scope of the reporting requirements.

In conclusion, AIPLA is asking for some minor modifications to the proposed regulations requiring reporting of patented transactions related to tax planning methods. Three changes are suggested, and would result in less burden on both the part of patent owners and the IRS.

1. Changing the definition of tax planning method to add the word "primarily" before "affecting" and expanding the exclusions to exclude patents having claims directed primarily toward business operation methods.

2. Excluding patent applications from the definition of the term patent.

3. Changing the words "the subject of the patent" twice in the definition of patented transaction to "is covered by one or more claims of the patent." This change will provide much more certainty in determining which transactions to report, and reduce irrelevant protective filings, yet also provide the IRS with exactly the information desired.

Thank you for considering our suggestions.